MORTGAGE SETTLEMENT COSTS

Of all the steps in buying a home or refinancing a loan, the mortgage closing or settlement probably causes more confusion and uncertainty for the borrower than any other.

A settlement may involve several people and a variety of documents and fees. Once you understand what is involved, you may find the entire closing process far simpler than you might have imagined. While this information focuses on settlements in home purchases, much of the information also will be useful if you are refinancing a mortgage.

Let's start with two important facts.

Fact number 1: Many buyers may think of settlement as the last step to becoming the legal owners of their new home. But it's a process that begins weeks or even months before, and follows an outline set largely by a buyer's original offer to the seller of the house. That offer becomes the sales contract, once it's signed by the seller, and it covers many of the key elements of the settlement or closing.

Fact number 2: Practices differ from one locality to another regarding who pays what closing costs. Across the country, however, buyers and sellers are free to negotiate certain fees. In some cases, certain costs can be shifted, it may affect the sale price of the property. In most states, costs can also be cut by shopping around among providers of the settlement services.

The point is this: **The more you know about the process, the better your chances are for saving money at settlement time.**

TYPES OF CLOSING COSTS

There are three basic categories of charges and fees in settlement or closing transactions:

◆ **Charges for establishing and transferring ownership.** These include title search, title insurance, related legal fees, and fees for conducting the settlement.
◆ **Amounts paid to state and local governments**. These include city, county, and state transfer taxes, recordation fees, and prepaid property taxes.
◆ **Costs of getting a mortgage.** These include survey, appraisals, credit checks, loan documentation fees, notary charges, loan origination, commitment and processing fees, hazard insurance, interest prepayments, and lender's inspection fees.

TITLE SEARCH: WHO OWNS WHAT?

When someone buys or sells a car, proving ownership is relatively easy. The owner has a certificate of title issued by the state in which the car is registered. When it comes to houses, providing clear title is not so simple. Moreover, your lending institution will not give you a mortgage loan on a house unless you can prove that the seller owns it. The proof comes in the title search.

How the title search is carried out depends upon where the property is located. In many parts of the country, public records affecting real estate title are spread among several local government offices, including recorders of deeds, county courts, tax assessors, and surveyors. Records of deaths, divorces, court judgements, liens, and contests over wills (all of which can affect ownership rights) also must be examined.

In a few localities, property records are fully computerized and the job can be completed fairly quickly. In the majority of localities, however, a title search must be performed to establish the seller's clear title. This means examining public records, in courthouses and elsewhere, to assure both you and your lender that there are no claims against the property that you are buying.

The title search may be carried out by an escrow or title company, a lawyer, or other specialist.

TITLE INSURANCE

In addition to a formal title search, your lender is likely to require a title insurance policy. The policy guards the lender against an error by the one who searched the title. (In some cases, the title insurer might arrange for or conduct the title search.) Let's say, for example, that a long-lost relative of the seller turns up with indisputable evidence that the relative, and not the seller, holds legal title to the property. Though it should have been found in the public records, the relative's claim was missed somehow. Errors are rare, but they do occur.

When this happens, the lending institution finds that it has loaned the home buyer thousands of dollars to buy a house from someone who did not own it. To avoid such problems, the lender will insist on title insurance prior to settlement. The cost of the policy (a one-time premium) is usually based on the loan amount and is often paid by the purchaser. There's nothing, however, to keep you from asking the seller, during your negotiations, to pay part or all of the premium.

The title insurance required by the lender protects only the lender. To protect yourself against unforeseen title problems, you may also want to take out an owner's title insurance policy. Normally, the additional premium cost is only a fraction of the lender's policy, but this can vary from area to area.

Some final advice on keeping title insurance costs low: If the house you are buying was owned by the seller for only a few years, check with a title company. If you can obtain a re-issue rate, the premium is likely to be significantly lower than the regular charge for a new policy. If no claims have been made against the title since the previous title search was done, the seller's insurer may consider the property to be a lower insurance risk.

Finally, shop around, not just for the premium (which can vary depending on how much competition there is in a market area), but for coverage as well. Generally, you should look for a policy with as few exclusions from coverage as possible. The exclusions are listed in each policy. Some policies have so many exclusions (situations under which the insurer will not pay for your title problems) that you end up with little coverage for your premium dollar.

GOVERNMENT IMPOSED COSTS

In some parts of the country, the transfer, recordation, and property taxes collected by local and state governments may be among the heftiest charges paid at settlement.

While there is no way to avoid paying these taxes, you may be able to lessen your share of the bill. Try shifting some or all of the cost to the seller. But, remember, you must do this when you make your offer to purchase the property.

MORTGAGE RELATED CLOSING COSTS

The costs of getting a mortgage may be imposed by your lender as early as when you apply for your loan. Mortgage related closing costs include:

◆ **Application Fee**. Imposed by your lender, this charge covers the initial costs of processing your loan request and checking your credit report.
◆ **Appraisal Fee.** This fee pays for an independent appraisal of the home you want to purchase. The lender requires this opinion or estimate of the market value of the house for the loan.
◆ **Survey**. At a minimum, the lender will require an independent verification from a surveying firm that your lot has not been encroached upon by any structures since the last survey conducted on the property. Alternatively, the lender may insist upon a complete (and more costly) survey to ensure that the house and other structures legally are where you and the seller say they are.
◆ **Loan Origination Fees and Discount Points**. The origination fee is charged for the lender's work in evaluating and preparing your mortgage loan. Discount points are prepaid finance charges imposed by the lender at closing to increase the yield to the lender beyond the stated interest rate on the mortgage note. One point equals 1 percent of the loan amount. For example, one point on a $75,000 loan would be $750. In some cases, especially in refinancing, the points can be financed by adding them to the loan amount that you borrow.
◆ **Mortgage Insurance.** Buyers who make down payments less than 20 percent (and in some cases 30 percent) of the value of the house may be required by lenders, and by law in some states, to take out mortgage insurance. The policy covers the lender's risk in the event the buyer fails to make the loan payments. Premiums are

typically paid annually from an escrow or reserve account, or in a lump sum at closing. A buyer, whose mortgage is insured by FHA or guaranteed by VA, will have to pay FHA mortgage insurance premiums or VA guarantee fees.

◆ **Homeowner's Hazard Insurance.** A form or protection against physical damage to the house by fire, wind, vandalism, and other causes. Your lender will expect you to have a policy in effect at closing.

MISCELLANEOUS CLOSING COSTS

Depending upon the location and type of property, and extra services you or your lender request, you may also have to pay some of the following at closing:

◆ **An assumption fee** charged when you are taking over or assuming an existing mortgage on the house. The size of the fee will depend on the lender, but it may range from several hundred dollars to 1 percent of the loan amount.

◆ **Home inspection fees** for an analysis of the structural condition of the property by an engineer or consultant, and for termite inspections.

◆ **Adjustments for various types of expenses prorated between the seller and the purchaser.** Some of the adjustments may involve large amounts. Local property taxes, annual condominium fees and other lump-sum service charges, for instance, may be split between you and the seller to cover your respective periods of ownership for the calendar year or tax period.

Settlements are conducted by lending institutions, title insurance companies, escrow companies, real estate brokers, or attorneys. In most cases, whoever conducts the settlement is providing a service to the lender. You may be required to pay for related legal services provided to the lender. You can also retain your own attorney to represent you at all stages of the transaction including settlement.

HOW CAN YOU ANTICIPATE HOW MUCH YOU WILL HAVE TO PAY IN CLOSING COSTS?

With such a long list of potential charges at settlement, it is important to know what to expect. To enable you to do that, the Congress passed the Real Estate Settlement Procedures Act (RESPA). Your mortgage lender is required to supply you with "good faith estimates" of all your closing costs within three business days of your application for a loan, together with a special information booklet called "Settlement Costs -- A HUD Guide." In addition, a statement of your actual costs should be given to you at or before settlement. Within the same three days, the lender is required, under the Truth in Lending Act, to provide you with a statement containing "good faith estimates" of the costs of the loan you have applied for, including your total finance charge and the annual percentage rate (APR). The APR expresses the cost of your loan as a yearly rate. This rate is likely to be higher than the stated interest rate on your mortgage, because it takes into account discount points, mortgage insurance, and certain other fees that add to the cost of your loan.

If you are refinancing a loan, the lender is not required to give the "good faith estimates" or the special information booklet. But you will receive the Truth in Lending disclosures before you settle.

This brochure has been prepared to help you make the important decisions involved in buying and financing your home. Because real estate settlement practices vary depending upon state law and local custom, this information should not be viewed as a replacement for professional advice. Talk with mortgage lenders, real estate agents, attorneys, and other advisors for information about lending practices, mortgage instruments, and your own interests before you commit to a specific loan.

The Indiana Department of Financial Institutions, Division of Consumer Credit has many other credit related brochures available, such as:

Answers to Credit Problems
Applying for Credit
At Home Shopping Rights
Buried in Debt
Car Financing Scams
Charge Card Fraud
Choosing A Credit Card
Co-Signing
Hang up on Fraud
High Rate Mortgages
Home Equity Credit Lines
How to Avoid Bankruptcy
Indiana Uniform Consumer Credit Code
Look Before you Lease
Mortgage Loans
Reverse Mortgage Loans
Scoring for Credit
Shopping for Credit
Using Credit Cards
Variable Rate Credit
What is a Budget?
What is the DFI?

Call our toll-free number or write to the address on the cover for a copy of any of the brochures listed or for further consumer credit information.

MORTGAGE SETTLEMENT GUIDE

DEPARTMENT OF FINANCIAL INSTITUTIONS
Consumer Credit Division
30 South Meridian Street, Suite 300
Indianapolis, Indiana 46204
317-232-3955
1-800-382-4880